No. 12845

# In the United States Court of Appeals for the Ninth Circuit

THE STUART COMPANY, A CORPORATION, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

THE STUART COMPANY, A CORPORATION, RESPONDENT

*ON PETITIONS FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES*

## BRIEF FOR THE COMMISSIONER

THERON LAMAR CAUDLE,
*Assistant Attorney General.*
ELLIS N. SLACK,
ROBERT N. ANDERSON,
GEORGE D. WEBSTER,
*Special Assistants to the Attorney General.*

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## CITATIONS

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## OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 41-59) are unreported.

## JURISDICTION

These petitions for review (R. 642-649, 652-654) involve federal income, declared value excess profits and excess profits taxes for the fiscal years ended March 31, 1943, March 31, 1944, and March 31, 1945. On Au-

gust 16, 1946, the Commissioner of Internal Revenue mailed to the taxpayer notice of a deficiency in the total amount of $137,467.87. (R. 12-13.) Within ninety days thereafter and on November 12, 1946, the taxpayer filed a petition with the Tax Court for a redetermination of that deficiency under the provisions of Section 272 of the Internal Revenue Code. (R. 3, 6-11.) The decision of the Tax Court was entered on September 22, 1950. (R. 60.) The case is brought to this Court by petitions for review filed December 21, 1950 (R. 649, 654), pursuant to the provisions of Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

## QUESTION PRESENTED

Whether certain payments made by taxpayer, the Stuart Company, under the agreement of November 28, 1942, were made, in part or in whole, to secure the cancellation of an onerous contract and hence are deductible as an expense under Section 23(a) of the Internal Revenue Code, or whether they were made, in part or in whole, for the purchase of a trade-mark, and hence constitute a capital expenditure under Section 24(a) of the Internal Revenue Code.

## STATUTE INVOLVED

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121(a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or Business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or busi-

ness, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

* * * * *

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

* * * * *

(26 U.S.C. 1946 ed. Sec. 24.)

STATEMENT

The facts as found by the Tax Court (R. 41-56) may be summarized as follows:

Taxpayer company was organized by Arthur Hanisch for the purpose of distributing the vitamin concentrate manufactured by Vita-Food under the trade name "The Stuart Formula" by making a personal approach to doctors and inducing them to recommend the product to their patients. Of taxpayer's 1,000 shares of stock Hanisch retained 600 shares,

transferring 250 shares to his associates and the remaining 150 shares to the representatives of Vita-Food. (R. 43.)

Hanisch also organized the Shaler Food Products Company to distribute through grocery stores a similar vitamin concentrate manufactured by Vita-Food under the trade names "Vitaplex" and "Calplex." The stock of this company was distributed in the same manner as that of the taxpayer. (R. 43-44.)

On May 5, 1941, the two new corporations, Vita-Food and Hanisch entered into a formal written contract covering certain prior informal agreements between Hanisch and Vita-Food. Under this contract the taxpayer agreed that the concentrate be sold and distributed under Vita-Food's trade-mark "The Stuart Formula," and was to retail at a given price. The Shaler Food Products Company agreed to sell the concentrate under the trade-mark "Vitaplex," and that it be retailed at a given price. Under this contract it was also agreed that the two corporations would purchase an average of 1,500 pints of the concentrate per day up to May 1, 1942, and after May 1 an average of 2,000 pints per day, failing which for any period of 60 days, Vita-Food could terminate the contract. The two corporations also agreed not to sell any product other than those manufactured by Vita-Food. It was specifically provided that any and all trade-marks or labels under which the concentrates were sold were to remain the property of Vita-Food. The contract was to remain in full force for a period of ten years, and could be extended for a further period of ten years at the option of the two new corporations; provided, however, that the contract could be terminated by Vita-Food if for any 60 consecutive days the corporations had not purchased the minimum quantities specified. (R. 44-47.)

Certificates of registration of the trade-mark "The Stuart Formula" were issued to Vita-Food by the State of California and by the United States Commissioner of Patents. (R. 48.)

The operations of the Shaler Food Products Company were never successful and that corporation was merged with the taxpayer on July 3, 1942. The taxpayer subsequently received permission from the Commissioner of Corporations to increase its capital stock by 1,000 shares, and these additional shares were issued to its original stockholders in proportion to their holdings. (R. 48.)

The taxpayer was never able to meet the purchase quotas called for in the contract, and on October 8, 1942, Vita-Food served notice upon it, stating that as it had failed to meet the quotas for a 60-day period the taxpayer's exclusive right to sell was terminated 60 days after the service of the notice; and—"In all other respects, the contract remains in full force and effect." (R. 49.)

The taxpayer replied that while it would endeavor to reinstate the contract by removing the shortages, it felt that it would be impossible. And further, the taxpayer answered Vita-Food by stating that if it were unable to reinstate the contract, it would regard the contract as terminated for all purposes. Taxpayer then consulted three trade-mark counsel on the question of the ownership of the trade-mark "The Stuart Formula." Two of these counsel gave as their opinion that Vita-Food owned the trade-mark. The other counsel stated that the registration of this trade-mark was cancellable upon application by the taxpayer. (R. 49-50.)

Hanisch conferred with Vita-Food in an attempt to settle their differences. He was unsuccessful and on November 23, 1942, the taxpayer and Hanisch sent

Vita-Food a notice of rescission of the contract, based upon fraud in the inception of the contract and failure of consideration in its performance. (R. 50-51.)

On November 25, 1942, Vita-Food filed suit in the Superior Court of the State of California for the County of Los Angeles, in which it asked that court to permanently enjoin the taxpayer and Hanisch from using the trade-mark "The Stuart Formula" upon any product not manufactured by Vita-Food. The court issued a restraining order on the same day, as requested by Vita-Food, and ordered the taxpayer to appear on a specified date and show cause why the restraining order should not be made permanent. (R. 51.)

Prior to the expiration of the time for filing an answer, a settlement of differences was reached. An agreement was entered into entitled "Agreement of Settlement of Litigation and Cancellation of Contract." Under this agreement Vita-Food agreed to dismiss its action in the state court with prejudice, and all parties agreed that the agreement of May 5, 1941, was cancelled. Vita-Food quit-claimed to the taxpayer the trade name "The Stuart Formula." The taxpayer and Hanisch agreed to pay Vita-Food $75,000; $35,000 was to be paid upon the execution of the agreement and $40,000 was payable at the rate of $4,000 per month. In addition, the taxpayer agreed to pay Vita-Food on a royalty basis and as further consideration for the execution of the agreement the sum of $122,700; this amount was to be paid at the rate of seven and one-half cents per unit of vitamin concentrate sold and marketed by the taxpayer beginning October 1, 1943, and continuing until the above sum had been fully paid. (R. 51-53.)

As early as February 1942, the taxpayer had begun negotiations with Vita-Food in an attempt to modify

the contract of May 5, 1941. It desired to acquire an express owner's interest in the trade-mark and wanted to obtain lower purchase quotas and lower purchase costs. On August 10, 1942, it rejected a proposed revision of the contract under which it was given a conditional one-half interest in the trade-mark provided its sales reached and maintained a certain level. (R. 48-49.)

On the basis of the foregoing, the Tax Court in a decision of Judge Harron held (R. 59) that the taxpayer was obligated to pay $75,000 under the contract of November 28, 1942, in order to secure the cancellation of an onerous contract, and $122,700 for the purchase of the trade-mark "The Stuart Formula." The present appeals followed.

## STATEMENT OF POINTS TO BE URGED BY THE COMMISSIONER

The statement of points relied upon by the Commissioner of Internal Revenue appears in the record at pages 655-656. It may be summarized as follows:

That the court below erred:

1. In holding that the taxpayer was obligated to pay $75,000 to Vita-Food under the contract of November 28, 1942, in order to secure the cancellation of an onerous contract and that this amount is properly deductible during the fiscal year 1943 as an ordinary and necessary business expense.

2. In failing to uphold the determination of the Commissioner that the entire payments of $197,700 ($122,700 plus $75,000) were capital expenditures made to purchase a trade-mark and are therefore nondeductible.

## SUMMARY OF ARGUMENT

The issue in this case relates to the consideration under a settlement agreement between the taxpayer

and Vita-Food Corporation. The taxpayer contends that the amounts paid by the taxpayer were for the cancellation of an onerous contract and hence are deductible as ordinary and necessary expenses. The Commissioner contends that the amounts paid were for the purchase of a trade-mark and hence are capital expenditures which are non-deductible. The Tax Court allocated a certain portion of the payments to the cancellation and the remaining portion to the purchase of the trade-mark "The Stuart Formula."

It is manifest that the finding that any part of the consideration for this settlement agreement was the cancellation of the 1941 contract is clearly erroneous. The attorney for Vita-Food testified that he at first demanded $300,000 to $350,000 for the trade-mark and that he was instructed not to sell the trade-mark for less than $200,000. It was actually sold for $197,700. He also testified that his company considered that the only consideration for the payment was the purchase of the trade-mark.

Moreover, the settlement agreement itself is not subject to the construction that any substantial part of the payments was made to buy off the onerous contract. It seems clear that the original contract had been terminated before the agreement involved here was entered into. The termination of the taxpayer's exclusive right to use the trade-mark completely destroyed the only consideration binding the taxpayer to the contract. Vita-Food's suit in the state court merely asked that the use of the trade-mark be enjoined and for no other relief. In such circumstances the finding that the cancellation of the contract constituted any part of the consideration is persuasive that a mistake has been committed by the trial court which is reviewable by this Court.

The argument that the trade-mark in the hands of the

Vita-Food Corporation was worthless as a matter of law is also without merit. If a trade-mark cannot be transferred without the good will that has been built up, then it is evident that the taxpayer was buying the good will that it had built up for the owner of the trade-mark.

ARGUMENT

**The payments made by the taxpayer company to Vita-Food Corporation under the agreement of November 28, 1942, constituted capital expenditures in that they were for the purchase of the trade-mark (The Stuart Formula) and hence are not deductible under Section 23(a) of the Internal Revenue Code as ordinary and necessary expenses**

Section 23(a)(1) of the Internal Revenue Code, *supra,* provides for the deduction of—

> All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business including * * *

The basis of the taxpayer's position is that the payments made to the Vita-Food Corporation under the agreement of November 28, 1942, were for the cancellation of an onerous contract and hence are deductible as ordinary and necessary expenses under Section 23(a) of the Code. Contrariwise, the Commissioner contends that the payments were for the purchase of the trade-mark (The Stuart Formula) and therefore are non-deductible capital expenditures[1] under Section 24(a) of the Internal Revenue Code, *supra.* The Tax Court concluded (R. 59) that under the 1942 agreement the taxpayer obligated itself to pay the sum of $122,700 for the purchase of the trade-mark "The

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[1] *Seattle Brewing & Malting Co.* v. *Commissioner,* 6 T.C. 856, affirmed *per curiam,* 165 F. 2d 216 (C. A. 9th); *Aluminum Products Co.* v. *Commissioner,* 24 B.T.A. 420; I. T. 2402, VII-1 Cum. Bull. 94 (1928); See also *Murphy Oil Co.* v. *Burnet,* 55 F. 2d 17 (C. A. 9th).

Stuart Formula" and $75,000 for relief from the terms of an onerous contract (by cancellation).[2]

It is of course well settled that the function of evaluating the evidence, of drawing inferences from underlying facts, of determining the weight to be accorded to the testimony of witnesses, of drawing the ultimate factual conclusions from the entire evidence, and of ascertaining the overall persuasiveness of the moving party's case are all matters committed to the fact finder. They are not to be reconsidered, *de novo,* by the reviewing court. Therefore, the ultimate conclusions of the Tax Court will not be disturbed on review unless "clearly erroneous," with proper regard being given to the opportunity "of the trial court to judge of the credibility of witnesses." Section 1141(a), Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948, c. 646, 62 Stat. 869. Rule 52(a), Rules of Civil Procedure; *United States* v. *Yellow Cab Co.,* 338 U.S. 338, 340-342; *United States* v. *Gypsum Co.,* 333 U.S. 364, 394-395; *Ruud* v. *American Packing & Provision Co.,* 177 F. 2d 538, 540 (C.A. 9th); *Grace Bros.* v. *Commissioner,* 173 F. 2d 170, 173-174 (C.A. 9th). Furthermore, the judgment reached by the Tax Court on the basis of the whole evidence will not be reversed if it is supported by substantial competent evidence unless the reviewing court reaches "the definite and firm conviction that a mistake has been committed". *United States* v. *Gypsum Co., supra,* p. 395.

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[2] There is no basis in the record for this division of the agreed payment; the November 28 settlement does provide for the payment of $75,000 on a more or less cash basis, and then $122,700 as "additional consideration" (R. 53), on a so-called "royalty basis", but there is no indication that the separation in the settlement was based on what the parties attributed to the value of a release from the onerous contract or the purchase of the trade-mark "The Stuart Formula." This "compromise" of the case was reached by the Tax Court, even though the position was not argued by the taxpayer or the Commissioner.

However, in the instant case, in which the taxpayer and the Commissioner have both filed petitions for review, it is manifest that the Tax Court's decision is clearly erroneous to the extent that any portion of the payments made by the taxpayer was attributed to the cancellation of the onerous contract and it follows that the taxpayer is wrong in contending that the entire sum should be attributable to the cancellation of the contract.

In the first place, it should be emphasized that the testimony of the organizer of taxpayer, Arthur Hanisch, that the taxpayer was not interested in the trade-mark "The Stuart Formula" and would not have paid anything for it (R. 179, 210) [3] is unpersuasive and also irreconcilable with certain actions prior to and during the negotiations for the settlement agreement. It was continually insisted that Vita-Food give the taxpayer an owner's interest in the formula. (R. 580-581.) Considerable expense was incurred to get from three different firms legal opinion dealing solely with whether or not the taxpayer could obtain the title to the trade-mark. (R. 155, 253.) The offer of Oscar Wiseman, attorney for Vita-Food, was refused; he offered to have Vita-Food execute written general releases, solely in return for a written disclaimer by the taxpayer to any interest in the trade-mark. (R. 443.) Certainly the taxpayer's continued use of the trade-mark is not consistent with a conclusion that it was valueless. Moreover, Mr. Wiseman testified that he asked $300,000 to $350,000 for the trade-mark (R. 453-454),[4] and Mr. Lewis, the managing director of the Vita-Food Corpo-

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[3] See also the testimony of Donald Royce. (R. 407-408.)

[4] These statements by witnesses for the Commissioner as to what they considered the value of the trade-mark are in the teeth of taxpayer's argument (Br. 36) that the Commissioner offered no evidence as to value.

ration, testified (R. 607) that he instructed Mr. Wiseman not to sell the trade-mark for less than $200,000.

There were several immediate circumstances leading up to the settlement agreement involved herein. On October 8, 1942, Vita-Food served written notice on the taxpayer that "you have failed to meet your quotas for the 60-day period * * * [exclusive right to use the trade-mark] is hereby terminated." (R. 49.) The taxpayer answered on October 12, 1942, and said it should attempt to reinstate the contract of May 5, 1941, but that if it were unable to do so, it would regard the entire contract as being at an end. (R. 49-50.) Beginning on November 18, 1942, there were a series of conferences with Vita-Food in order to settle their differences. (R. 50.) On November 25, Vita-Food filed a suit asking that the taxpayer be enjoined from using "The Stuart Formula" and a temporary restraining order was issued. (R. 51.) The settlement occurred on November 28, and on November 30, Vita-Food delivered to the taxpayer the certification of registration of "The Stuart Formula." (R. 55.) While the settlement agreement contained cancellation recitals, it is clear from the record that the taxpayer could and did obtain this cancellation without any cost. Several times during the course of the negotiations Mr. Wiseman told Mr. Hanisch and Mr. Dunlap that Vita-Food did not contend that the taxpayer was bound by the May 5 contract after Vita-Food's October 8 notice of termination of taxpayer's exclusive right to use the trade-mark (R. 460-461), and that if all that the taxpayer wanted was a release from the May 5 contract, Vita-Food would give that, on the condition that the taxpayer sign a disclaimer of any right or interest in and to the trade-mark (R. 443-444, 448-449).

Corroborative of this statement of Mr. Wiseman is the nature of the law suit instituted by Vita-Food on

November 25, 1942. This injunction suit by Vita-Food was initiated because the taxpayer claimed ownership of the trade-mark and intended to buy vitamin products from other sources and market them under the trade-mark. (R. 466-467.) Thus, the purpose of the injunction suit was to enjoin the taxpayer from using the trade-mark on products not manufactured by Vita-Food. If Vita-Food had been contending that the taxpayer was bound under the May 5 contract, the injunction suit of May 25 would also have sought to enjoin the taxpayer from buying vitamin products from other manufacturers. The filing of this limited injunction suit by Vita-Food was notice to the taxpayer that Vita-Food had no intention of trying to hold the taxpayer to the May 5 contract and was in effect acquiescence in the taxpayer's cancellation notice of October 12, 1942, and its notice of rescission of November 23, 1942. Also in this connection it should be noted that paragraph 10 of the May 5, 1941, contract (R. 46) provided that the cancellation of part of taxpayer's right under the contract had the effect of terminating all of its rights. This provision is as follows:

> * * * and the right or rights of first parties to distribute and/or market or offer for sale such products or any other product hereafter produced by second party shall continue only so long as this agreement is in full force and effect.

It follows that, in any event, the contract would not have been enforceable against the taxpayer after the effective date of the cancellation notice of October 8 (December 9). Thus, at the time of the November 28th agreement, the only thing actually remaining about which to bargain was the ownership of the trade-mark "The Stuart Formula." As Mr. Wiseman testified (R. 473):

> We were selling a trade-mark. That was the consideration.

And as he further stated on cross-examination when questioned relative to the fact that the $197,700 was paid merely for the trade-name "The Stuart Formula" (R. 501):

> Yes, I mean to say that. And, as I told Mr. Dunlap and Mr. Hanisch at the time, the rest of these claims and rescission action was so much eye wash. I told them that with emphasis. I certainly do feel that the only thing that was under discussion, that permitted any discussion was the trade-mark, and I so told Mr. Dunlap and I so told Mr. Hanisch.

Therefore, the conclusion of the Tax Court (R. 58) that the taxpayer entered into negotiations with Vita-Food to effect a settlement of the contract and that $75,000 of the amount paid to Vita-Food should be allocated to this item, is clearly erroneous.

Moreover, it is difficult to understand why, under the circumstances, even if Vita-Food had taken the position that the taxpayer was still bound to the contract of May 5, the taxpayer would or should have paid more than a nuisance amount, inasmuch as the termination of the taxpayer's exclusive right to use the trade-mark destroyed the only consideration binding the taxpayer to the contract. Thus, the contract was unenforceable, and being under advice of counsel, it is clear that the taxpayer would not have paid anything to cancel an unenforceable contract. The taxpayer's lawyer, in fact, admitted that he felt perfectly sure that he could have the contract cancelled. (R. 328-329.) Moreover, his reasons for saying that he permitted his client to pay $197,700 for Vita-Food's acquiescence in a cancellation of the contract because it would involve the disclosure of things that would destroy the public confidence in taxpayer's product (R. 330, 339) are unconvincing. It seems manifest

that a suit for cancellation would have involved no such risk.

The taxpayer attempts to infer (Br. 18) that since the royalty payments under the settlement were to begin a year after the date of the agreement it follows that the payments were not for the purchase of the trade-mark. However, this loses sight of the contention of the Commissioner on this appeal that the entire amount—the first $75,000 and the later $122,700—was paid for the purchase of the trade-mark.

The taxpayer's contention is (Br. 23-25), in effect, that the agreement involved herein by its terms indicates that the amounts paid were for the cancellation of the contract. However, it is manifest that the only real significance that can be given to the presence in the settlement agreement of the various cancellation recitals, such as in the title "Agreement of Settlement of Litigation and Cancellation of Contract" (R. 51), is that the original contract would not otherwise have terminated under its own provisions until several days later, i.e., December 9, 1942, or sixty days from the date of Vita-Food's cancellation notice, October 8, 1942. Also, in any arrangement of this kind, it seems clear that the parties would want to clarify each and every facet of the disagreement. It is customary and usual in agreements of this character to incorporate a provision for the release and discharge of all possible past, present or future claims or demands arising out of the transaction. Such provisions of an indenture are of little importance in the determination of the parties' intent. Cf. *Inaja Land Co.* v. *Commissioner,* 9 T. C. 727. In addition it is evident that the agreement was so drafted as to give the best possible basis for the deduction of the cost of the trade-mark as a business expense. This is consistent with the fact that the payments were stated to be "on a royalty basis." (R.

53.) This was the alternate method of terming the payments used in the taxpayer's petition for review (R. 6-11), and amended petition for review (R. 25-31) in the Tax Court. The taxpayer here has dropped the "royalty basis" claim and merely says that the payments were for the cancellation of an onerous contract.

The taxpayer argues (Br. 25) that Vita-Food agreed to execute assignments of the trade-mark "if requested." According to the taxpayer, this indicates that the trade name had little significance to the contracting parties. It should initially be noted that this clause is taken from its context, and was inserted in the agreement *only after Vita-Food had quitclaimed its right and title in the trade-mark to taxpayer.* It also overlooks the important fact that the taxpayer did request and receive the assignments. Mr. Wiseman, when asked if he would use this language in making a purchase for his client stated (R. 506):

> Well, that language is actually Mr. Dunlap's, but I agreed to it. I see no reason why that language should not be used again in a similar case. The point was made quite clear and we all agreed that we would make an assignment in proper form so that the trade-marks of record with the Patent Office and with the California Secretary of State would show of record the ownership by Stuart Company, and that it was understood and agreed that any time they wanted it they could have an appropriate assignment.
>
> The fact they did not formally request it or present a form until later made no difference to me. We knew that sooner or later, whenever they got around to it, we would execute appropriate assignments to be recorded with the respective public authorities.

The taxpayer further argues (Br. 37) that the fact of net operating losses in the Stuart Company during the period of March 27, 1941, and October 31, 1942 (R.

55), indicates that the trade name "The Stuart Formula" was therefore worth very little. This fails to take into consideration the fact that these were the formative years and that it would not be expected that the sale of a product of this kind would be gainful until the product had been well advertised and all the preliminaries had been performed. The taxpayer was aware of this and for that reason was willing to pay this sum for the purchase of the trade-mark and reap the benefits of two years of groundwork that had already been carefully laid.

The inconsistency of the taxpayer's position is illustrated by the fact, as already pointed out, *supra,* that it originally contended that the amounts were not for the cancellation of an onerous contract but were, at least in part, payments to Vita-Food representing royalties. This is analagous to the situation in *Battle Creek Food Co.* v. *Commissioner,* decided February 28, 1949 (1949 P-H T.C. Memorandum Decisions, par. 49,049), affirmed *per curiam,* 181 F. 2d 537 (C. A. 6th), in which the question was whether or not the payments under a settlement agreement represented royalties or the purchase of certain intangibles such as trade names, trademarks, secret process and formulae. It was held that the total amount was in payment for the intangibles. The taxpayer, however, took the position in the trial proceedings that the entire amount constituted payment of royalties whereas in the unamended petition it had been alleged that a certain portion of the payments represented payment for the intangibles. This inconsistency of approach was revealing of a basic weakness in the taxpayer's tax treatment in that case and it should so be considered here. In fact, by first terming the payments "royalties," it is clear that the taxpayer was thinking in terms of the trade-mark rather than cancellation of the contract of May 5, 1941.

Moreover, even if the cancellation of the contract constituted a part of the consideration for the payments made by the taxpayer, it did not establish a basis for the allocation of a portion of such payment to the cancellation. Indeed, the lack of basis for allocation of any part of the payments to the cancellation is persuasively illustrated by the vacillating nature of the taxpayer's claims. As pointed out *supra,* the taxpayer in the petition before the Tax Court (R. 6-11, 25-31) alleged that the payments were either for cancellation or royalties and now the taxpayer is alleging only that they were for cancellation. And even though part of the consideration might be susceptible of allocation to ordinary and necessary expenses, the whole will be considered capital outlay unless the taxpayer proves the proper distribution. *Aluminum Products Co.* v. *Commissioner,* 24 B.T.A. 420; *Battle Creek Food Co.* v. *Commissioner, supra.*

The argument of the taxpayer (Br. 43-48) that the trade-mark "The Stuart Formula" in the hands of the Vita-Food Corporation was worthless as a matter of law is misleading and is completely without merit. The taxpayer misconceives the concept of the early trade-mark doctrine [5] that a trade-mark could only be transferred with the business to which it relates. See 2 Callman, The Law of Unfair Competition and Trade-marks, Sec. 78 (1945). It is argued that, since Vita-Food did not have any good will to transfer and that since no physical assets were transferred by the settlement agreement, merely the naked name or trade-mark was transferred. From this premise it is further contended that nothing of value was transferred since the trade-mark owner does not have a right to a particular

[5] The present development of the law of trade-marks is to the effect that it is the intangible value (good will) and not the physical assets which the trade-mark represents.

word but to the word used as the symbol of particular goods. In this case, however, there can be no doubt that a valuable good will attached to the trade-name, then the property of Vita-Food, even if it were the taxpayer that had built up such good will. Thus, the taxpayer was purchasing a trade-mark with the accompanying good will, even though the good will might have been created by it. In substance, the taxpayer had been improving the property of Vita-Food and had to pay for that improvement upon receipt of title. This is analogous to a lessee's making permanent improvements to realty and later having to purchase these improvements at the time he buys the original property.

A consideration of all the facts of this case indicates that the finding of the Tax Court—that any part of the payment made by taxpayer to Vita-Food represented a payment for the cancellation of the May 5, 1941, contract—is in no sense supported by the record and is clearly erroneous.

## CONCLUSION

Accordingly, the Tax Court should be reversed in so far as it held that any part of the payment made by taxpayer under the 1942 agreement to Vita-Food is deductible as a business expense.

Respectfully submitted,

THERON LAMAR CAUDLE,
*Assistant Attorney General.*

ELLIS N. SLACK,
ROBERT N. ANDERSON,
GEORGE D. WEBSTER,
*Special Assistants to the Attorney General.*

JULY, 1951.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1951 956429 941